

STATE OF CALIFORNIA

DEPARTMENT OF INSURANCE

45 Fremont Street, 24th Floor

San Francisco, California 94105

INITIAL STATEMENT OF REASONS

Date: April 29, 2005 RH02024219

REGULATIONS CONCERNING MUTUAL FUND INVESTMENTS IN VARIABLE PRODUCTS

INTRODUCTION

Pursuant to Insurance Code Section 10506(h), Insurance Commissioner John Garamendi proposes to add to Title 10, California Code of Regulations, Chapter 5, Subchapter 3 article 11.3, Sections 2534.40, 2534.41, 2534.42, 2534.43, 2534.44, 2534.45, 2534.46 and 2534.47. Insurance Code Section 10506(h) permits the Commissioner to review filings for amendments to insurers' variable contract authority to see if hazardous operations exist. In 2002, the Legislature amended Insurance Code Section 10506(h) to permit insurers to implement material changes, involving mutual funds underlying the variable contract separate accounts connected with a variable contract, without the Commissioner's approval or acknowledgement prior to implementation. The proposed regulation specifies defines what material changes are still subject to the Commissioner's prior approval and it defines what constitutes a Mutual Fund Investment. The proposed regulation sets out criteria for the Commissioner to consider in determining if a variable product involves hazardous operations. The proposed regulation also establishes what constitutes a complete filing and the types of forms that should accompany a filing.

SPECIFIC PURPOSE AND REASONABLE NECESSITY OF REGULATION

The specific purpose of each adoption and the rationale for the Commissioner's determination that each adoption is reasonably necessary to carry out the purpose for which it is proposed are set forth below:

§2534.40

In 2002, the Legislature enacted amendments to Insurance Code Section 10506(h) to enable insurers to implement material changes, involving mutual funds underlying the variable contract separate accounts connected with a variable contract, without the Commissioner's approval or acknowledgement prior to implementation. The Legislature also directed that the Commissioner promulgate regulations to supersede Insurance Department Bulletin 97-2. This section delineates the Commissioner's authority to issue these regulations.

§2534.41

The proposed regulation clarifies what material changes to an insurer's variable authority still require the Commissioner's prior approval or acknowledgment. The proposed regulation also

explicitly states that material changes involving Mutual Fund Investments are not subject to the Commissioner's prior approval or acknowledgment prior to implementation. This regulation clarifies that not all material changes to an insurer's variable authority may be implemented without the Commissioner's prior approval or acknowledgement.

§2534.42

This proposed regulation sets out the definition of a Mutual Fund Investment. The proposed regulation also defines filings made pursuant to Section 2534.46 of these proposed regulations to be deemed as notifications as delineated in Insurance Code Section 10506(h). This regulation clarifies the type of filings that were affected by the 2002 amendments to Insurance Code Section 10506(h).

§2534.43

This proposed regulation sets out the notifications and procedures required for the Commissioner to determine if hazardous operations exist in a filing for amendments to an insurer's variable authority involving Mutual Fund Investments. It also defines what does not constitute a hazardous condition or operation. Should the Commissioner determine the existence or a hazardous condition or operation, the proposed regulation details the procedure for notifying an insurer of this finding and the insurer's ability to contest the Commissioner's findings. This regulation provides the Commissioner guidelines for determining if hazardous operations exist in a variable product. These guidelines are similar to existing guidelines contained in Insurance Department Bulletin 97-2. Insurers have been making filings in compliance with Insurance Department Bulletin 97-2 since 1997.

§2534.44

This proposed regulation details the procedure for determining the existence of hazardous operations in investments not involving Mutual Fund Investments. It essentially follows the process described in Insurance Department Bulletin 97-2 and proposed Section 2534.43.

§2534.45

This proposed regulation sets out factors that determine if hazardous operations are involved in a variable annuity or variable life insurance product. The proposed regulation also states that the Commissioner reserves the right to review a filing for hazardous conditions if there is good cause to believe that the issuance a variable contract may pose a hazard to California policyholders or the public. One factor that may cause the Commissioner to review a variable contract is if there is good cause to believe that a material risk is not being adequately disclosed. This regulation provides the Commissioner with additional factors to consider in making a determination of whether a hazardous operation is involved in a variable produce. It uses factors described in Insurance Bulletin 97-2. In conjunction with proposed Section 2534.43, it essentially restates Insurance Bulletin 97-2.

§2534.46

This proposed regulation sets out the requirements for a completed filing. In addition, the proposed regulation states that if the Commissioner determined that a filing for a material change fails to comply with the filing requirements or is otherwise incomplete, the Commissioner shall issue a letter rejecting the filing for a material change. This regulation is intended to insure that

all filings made pursuant to these regulations are complete and that they make all of the required disclosures. It is intended to prevent an insurer from making an incomplete filing and then attempting to use Insurance Code Section 10506(h) as authority to implement a material change to its variable authority.

§2534.47

This proposed regulation sets out the forms that are to be used in conjunction with these regulations in making a filing for a material change to a variable contract. As stated previously, these forms are virtually identical to the forms that are contained in Insurance Department Bulletin 97-2. These forms have been used since 1997. The purpose of the forms is to insure that adequate disclosure of information is made so that the Commissioner can make a determination if hazardous operations are involved in the variable product filing.

The proposed regulations will implement the statutory changes caused by Assembly Bill 2778 which was enacted by the Legislature in 2002. In addition, pursuant to Insurance Code Section 10506(h), the proposed regulations would replace Insurance Department Bulletin 97-2. The Commissioner believes that the proposed regulations are necessary to carry out the express intent of the Legislature, as articulated in the Statute.

IDENTIFICATION OF STUDIES

There are no specific studies relied upon in the adoption of this article.

SPECIFIC TECHNOLOGIES OR EQUIPMENT

Adoption of these regulations would not mandate the use of specific technologies or equipment.

ALTERNATIVES

The Commissioner has determined that no reasonable alternative exists to carry out the purpose for which the regulations are proposed.

ECONOMIC IMPACT ON SMALL BUSINESS

The Commissioner has identified no reasonable alternatives to the presently proposed regulations, nor have any such alternatives otherwise been identified and brought to the attention of the Department, that would lessen any impact on small business. It is anticipated that the regulation would not adversely affect small business.

PRENOTICE DISCUSSIONS

The Commissioner conducted informal prenotice discussions on the proposed regulation in 2002 and 2003. As a result, the current text of the regulation was changed in response to many of these comments. For this reason, it is unlikely that the interested parties will find the proposed regulations too complex or multifarious to be reviewed easily during the comment period and it is not anticipated that the adoption of the proposed regulations will be particularly controversial.